

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 02-0303
Sales and Use Tax
For the Years 1998-2001

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ISSUE

I. Sales and Use Tax- Imposition

Authority: IC 6-2.5-2-1, IC 6-2.5.3.2, IC 6-2.5-4-10, IC 6-2.5-3-3, IC 6-2.5-6-1.

The taxpayer protests the assessment of use tax on certain equipment leases.

STATEMENT OF FACTS

The taxpayer was formed as an S corporation on January 1, 1997 to provide medical and chiropractic services to patients. The primary chiropractic service provider had previously provided chiropractic services under another S corporation wholly owned by him. The chiropractor wholly owned the taxpayer in 1997.

To improve his billings and collections, the chiropractor was advised by an outside consulting firm to provide his services in conjunction with a medical doctor. Following the consultant's recommendation, the chiropractor transferred the stock in the corporation to a medical doctor at the beginning of 1998.

The medical doctor performed services for the corporation on a very limited basis and was compensated on an hourly basis for those limited services. He was not given a set salary, nor did he participate in any management activities of the corporation. Instead, whatever income that was generated by the corporation was paid to the chiropractor.

For business planning purposes, the chiropractor formed a second wholly owned corporation. The second corporation owned primarily all of the equipment required to provide chiropractic services to the chiropractor's patients. An equipment lease was entered into between the taxpayer and the second corporation beginning in 1998. The taxpayer agreed to lease the equipment for \$3,500 per month or \$42,000 per year even though the actual cost of the equipment approximated only \$70,000. Sales tax was paid on the acquisition of this equipment. The rental amount was accrued on each company's books at \$42,000 per year, or \$168,000 for the four years in question, but no rent was ever paid by the taxpayer to the second corporation.

Both the taxpayer and the second corporation were cash basis taxpayers for income tax purposes. The taxpayer never recognized any equipment lease expense for tax reporting purposes. The second corporation never recognized any equipment lease income for tax reporting purposes. The

equipment lease agreement stated that the taxpayer was responsible as the lessee for all required taxes such as sales or use taxes. No sales or use taxes were ever paid with respect to the lease because no rent was ever actually paid in cash.

As of December 31, 2001, the taxpayer had accrued an equipment lease payable to the second corporation of \$168,000 for book, not tax, reporting purposes. The second corporation had a corresponding equipment lease receivable on its books. On December 31, 2001, the chiropractor purchased 100 % of the stock of the taxpayer from the medical doctor. A moment after the ownership changed hands, the taxpayer entered into a plan of merger with the second corporation and two other corporations owned by the chiropractor. The taxpayer became the surviving corporation. As a result of these actions, the equipment lease receivable and payable were cancelled, without any funds changing hands, and these accrued entries were removed from the books of the newly merged entity. The chiropractor resumed his prior method of doing business and just charged for chiropractic services without any medical doctor referrals.

In an audit for the years 1998-2001, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed use tax on the equipment. The taxpayer protested the imposition of the use tax and a hearing was held.

I. Sales and Use Tax- Imposition

DISCUSSION

Indiana imposes a sales tax on retail transactions made in Indiana. IC 6-2.5-2-1. A complementary use tax is imposed on personal property purchased in a retail transaction and used in Indiana when no sales tax has been paid. IC 6-2.5-3-2. For the purposes of the sales and use tax, retail transactions include lease transactions. IC 6-2.5-4-10. The amount of the use tax is measured by the gross retail income received. IC 6-2.5-3-3.

The taxpayer agrees that the situation was set up as a lease transaction subject to the sales and use taxes. Pursuant to the lease agreement submitted at the hearing, the taxpayer was to pay any state retail taxes imposed on the taxpayer's use or the other corporation's acquisition of the leased equipment. Therefore, as the corporations were set up and pursuant to the signed lease, the taxpayer should have reported and remitted use tax on the use of the leased equipment each month as required by IC 6-2.5-6-1.

The taxpayer argues that since it never actually collected any money, it never had any actual gross income from the leases to measure the amount of use tax due to the state. The taxpayer errs in this conclusion. The taxpayer observed the formalities of a lease in every respect but one. The fact that the taxpayer failed to make any lease payments does not abrogate the existence of a lease, which is a retail transaction. The taxpayer's assertion that it was a cash basis taxpayer is contradicted by the fact that it recorded the lease amounts in accounts payable. It is not relevant that the lessor did not insist on payment.

FINDING

The taxpayer's protest is denied.